OLIVER WYMAN

Retail

Getting Availability Right: Bringing Out-of-Stocks Under Control

Ensuring product is on the shelves is vital for retailers – but driving out-of-stocks down usually requires more inventory or more labor in the store. Significant gains can be achieved at much lower cost by improving the way on-shelf availability is measured and managed.

Ensuring product is on the shelf is essential for any retailer, but even today it remains a major challenge. For example, it's not unusual for a supermarket to miss out on 5% of sales through out-of-stocks. As well as hurting revenue, poor availability means dissatisfied customers, and poorer financial performance over the long term.

Often, availability suffers because it is not well understood. It is the final outcome of a complex chain of events: buyers need to forecast and order accurately, suppliers need to deliver the right quantities at the right time, distribution needs to ensure the product reaches the stores, and the stores themselves need to get it onto the shelves. This cross-functional complexity means that when an out-of-stock occurs it can be unclear who or what has caused it – making the problem very difficult to fix.

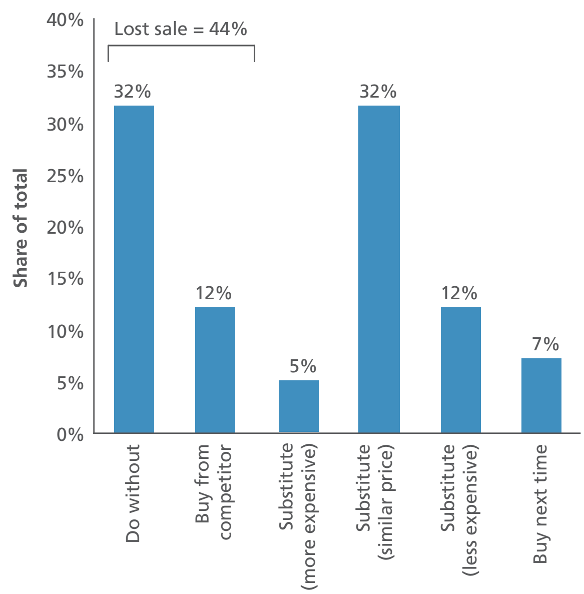
This paper explains why out-of-stocks are so costly, and suggests ways that retailers can tackle availability problems by better understanding their causes. It reflects our experience of working with retailers in a variety of geographies over the past decade.

The importance of availability

When they can't find the product they want, customers react in a number of different ways. Exhibit 1 is based on research we carried out by accompanying customers on their weekly grocery shops: as it shows, most customers purchase a substitute product, and only around one in eight ends up buying the item from a competitor. But it's important to keep in mind that indirect effects multiply the cost of out-of-stocks: although customers will rarely switch an entire shopping trip to a competitor to find an item, losing an entire basket in this way can be twenty to thirty times more expensive than losing the sale of a single item.

Less common still – but even more costly – are cases in which an out-of-stock represents the 'final straw' for a customer, and they defect to a competitor for the long term. Such behavior is often impossible to measure, but is very important. In retail sectors where shoppers visit a store to buy one specific product, availability problems can provoke 'permanent' store switching by removing a store from a customer's consideration set for future purchases. And in grocery – with its high visit frequency – it is worth considering that if as few as one in five thousand customers inconvenienced by an out-of-stock is permanently lost, the ultimate cost will be similar to the direct sales loss. Note in this context that almost one in three of those who experienced an out-of-stock cited it as the thing they were least satisfied with about the store, and over two-thirds were at least mildly annoyed; more worryingly, many also commented on out-of-stocks experienced during *previous* visits.

Exhibit 1
How Customers Respond to Out-Of-Stocks



Poor availability can cost at least 5% of sales

We typically find that for food retailers, around 94%-97% of products (on a sales-weighted basis) are in stock at any given time. Combining this figure with the pattern of customer responses just described implies that out-of-stocks can cost more than 5% of total sales, once longer-term effects and customer dissatisfaction are taken into account. All in all, then, achieving better availability is a worthwhile goal – and since there is also a big difference between the best and worst performers, most retailers have room for improvement.

Developing an accurate picture of out-of-stocks

Correcting availability problems begins by better understanding their root causes. While it may sound surprising, few retailers have a good grasp of where, when, and why out-of-stocks occur.

The flow of product from a supplier or distribution center to the store may be systematically tracked, but the availability that matters is on the shelf – not in the stockroom.

> *Out-of-stocks are more common than most retailers realize*

The methods used to track availability are often low-tech. A common technique is to perform manual checks of the quantity of key items on the shelves at specified times every day or week, in some cases supplementing these with store inventory tracking data (retailers who pick product from their shelves for home delivery can generate

Exhibit 2 **Statistical Availability Monitoring**

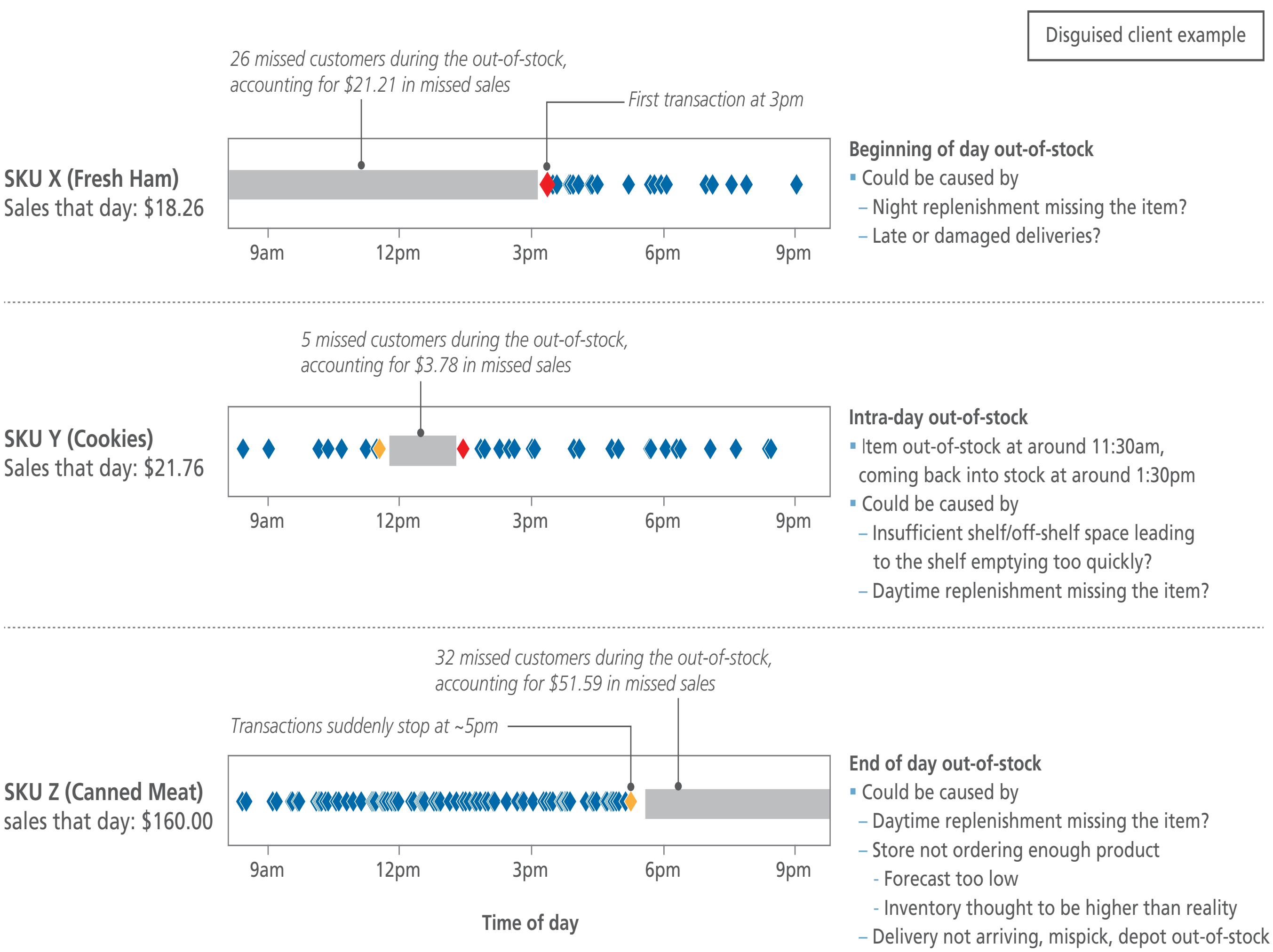
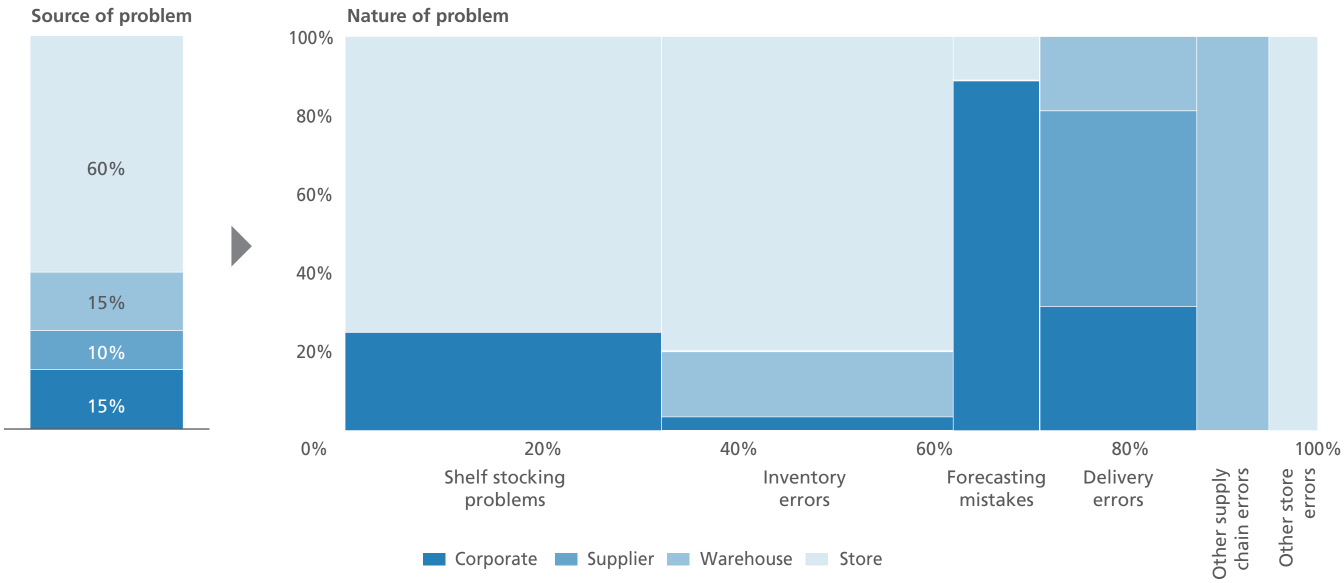


Exhibit 3 **What Causes Out-Of-Stocks?**



this type of information at much lower cost). Additional data may also be provided by vendors, though this gives only a partial picture, and risks being subject to bias.

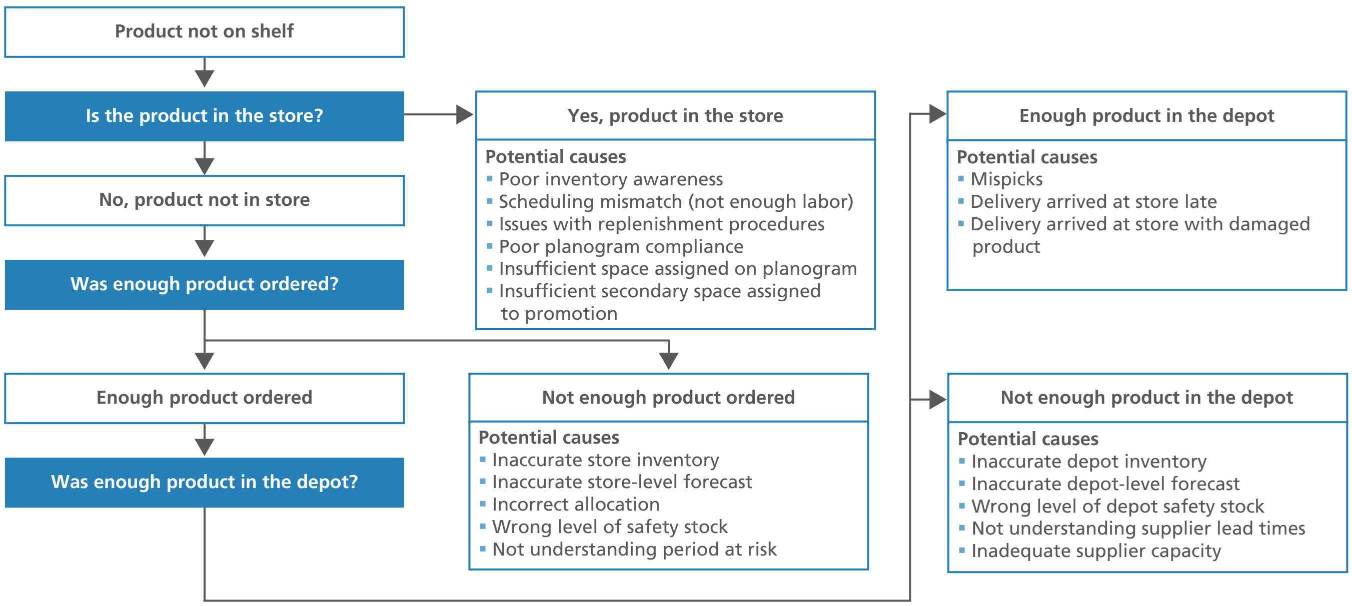
However, such approaches suffer some fundamental flaws – all of which mean the true extent of out-of-stocks tends to be underestimated. First, they don't track availability for all products, only those with sufficient volume to justify the (high) cost of manual checks. Second, they miss a significant proportion of out-of-stocks, since checks take place periodically. If a product is unavailable between checks, then the business will not know about it – only customers will. And third, they don't give a good indication of how long a product is out of stock, making it impossible to quantify the missed sales opportunity with any degree of accuracy.

All this information is important, because there is a strong relationship between the cause of an out-of-stock and its timing, duration, and which products are affected. This makes it essential to track availability at a detailed level, and on a continuous basis rather than relying upon occasional snapshots.

A better way to spot out-of-stocks is by analyzing sales data. Exhibit 2 gives a simplified output generated by Statistical Availability Monitoring, an Oliver Wyman technique for doing this. When an item registers zero sales for a certain period, this might be an out-of-stock, or it might just mean the item is a slow seller. Which is more likely can be predicted by applying statistical algorithms to the historic sales pattern of each product, allowing those cases where availability problems are highly probable to be highlighted. Results at store-SKU level can then be used to pinpoint out-of-stocks during any time period (the length of which will vary across retail sectors based on their different rates of sale – minutes in grocery, hours in most non-food retail).

Armed with an accurate picture of when and where out-of-stocks occur, a retailer can diagnose the root causes – because different problems have different 'signatures' for the out-of-stocks they create. Exhibit 3 shows an example breakdown of out-of-stocks and their causes, again drawn from a grocery retailer. Over half of the problems originate from the store, not the supplier or the distribution center: in our experience this pattern is typical, though in many cases it is not acknowledged by retailers.

Exhibit 4 **Out-Of-Stock Troubleshooting**



How to get availability right

Different types of availability problem require different remedies with different associated costs, so the financial impact of better availability depends on how it is achieved. Developing a comprehensive picture of the root causes of out-of-stocks is therefore the first requirement for tackling them in ways that make financial sense. Clearly, there are many other obstacles which must be overcome in order to deliver improved availability on the shelf. A detailed discussion is beyond the scope of this paper, but in closing we make a few comments about some of the key organizational considerations.

Many retailers adopt a simple philosophy to improving availability, 'making it the store's problem' by introducing new targets and incentive structures that motivate managers to minimize out-of-stocks. This can generate small improvements, but it will not address availability problems that originate outside the store. Moreover, the cost of store labor, shrink, and shelf space needs to be balanced against the sales benefit from better availability: simplistic approaches may reduce out-of-stocks only by reducing profits at the same time.

Understanding exactly why a product didn't make it onto the shelf allows more effective solutions. For example, if a product sometimes goes out of stock for a few hours during the day, replenishment practices may need to be changed. One retailer established a troubleshooting process similar to the one shown in Exhibit 4.

Data alone is not enough – delivering significant improvements requires careful change management

Providing store managers with detailed and up-to-date information – about which products went out of stock, when, and for how long – equips them to work through the troubleshooting process and address failures in specific areas. At the same time, it is essential not to underestimate the change management challenge involved in addressing availability problems: invariably, both upgraded systems and new management processes are required, often in diverse areas of the business.

Because as well as making out-of-stocks difficult to diagnose, the complex chain of events involved makes them difficult to fix. Where availability problems originate in corporate HQ or the warehouse, there needs to be a process in place to identify and deal with this, and to avoid blaming stores for failures over which they have no control.

On the other hand, store managers should be given full visibility of and responsibility for managing out-of-stocks which originate in the store. Targets and budgets need to be carefully revised, and in a way that is both fair, and seen to be fair: each store needs to be compared to other stores whose availability might be expected to be the same, not just estate-wide 'best in class' benchmarks or a crude top-down target. Since better availability usually implies additional costs for the stores and additional revenue for the business as a whole, this also needs to be recognized and reflected in budgets and personal targets.

Overall, then, it is important not to underestimate the barriers to change, especially when considering a 'systems-centric' solution. Although better information is always necessary for better availability, it is never sufficient by itself.

Concluding remarks

Managing on-shelf availability is a significant challenge – but it also offers a significant opportunity to increase sales and customer satisfaction. To reap these benefits, a retailer needs a clear picture of where, when, and why out-of-stocks occur, and a strategy for dealing with them that acknowledges the financial trade-offs and organizational challenges involved. Ultimately, since most availability problems can be traced back to the stores, store management needs to be equipped with more accurate ways of pinpointing them, and empowered to change operating practices accordingly. ❖

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About Oliver Wyman

Oliver Wyman's Retail Practice has a 20-year track record of helping clients deliver high-impact performance improvements. We combine deep industry knowledge with clear insight into what it takes to succeed in retail. Our proprietary, state-of-the-art analytical tools and techniques provide an unrivalled understanding of how to create shareholder value, and we work closely with clients to develop practical, real-world solutions that make this happen.

Oliver Wyman is a leading global management consulting firm with more than 3,000 professionals in over 50 cities around the globe.

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